

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name Sturgis Hospital and Related Entities	County St. Joseph
Fiscal Year End September 30, 2006	Opinion Date November 2, 2006	Date Audit Report Submitted to State December 21, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

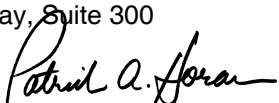
YES
NO

Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input checked="" type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>			
Other (Describe)	<input type="checkbox"/>			
Certified Public Accountant (Firm Name) Plante & Moran, PLLC		Telephone Number (269) 567-4500		
Street Address 750 Trade Centre Way, Suite 300		City Portage	State MI	Zip 49002
Authorizing CPA Signature 	Printed Name Patrick A. Horan		License Number 1101010473	

Sturgis Hospital and Related Entities

**Combined Financial Report
with Additional Information
September 30, 2006**

Sturgis Hospital and Related Entities

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Independent Auditor's Report

To the Board of Directors
Sturgis Hospital and Related Entities

We have audited the accompanying combined balance sheet of Sturgis Hospital and Related Entities (component units of the City of Sturgis, Michigan) as of September 30, 2006 and 2005 and the related combined statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Sturgis Hospital and Related Entities at September 30, 2006 and 2005 and the combined results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying combined financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be a part of, the basic combined financial statements.

Plante & Moran, PLLC

November 2, 2006

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Sturgis Hospital and Related Entities

Combined Balance Sheet

	September 30, 2006	September 30, 2005
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 2,406,367	\$ 2,996,040
Accounts receivable (Note 4)	6,048,022	5,182,943
Assets limited as to use (Notes 2 and 3)	248,490	2,070,183
Other current assets	1,236,531	1,313,714
Total current assets	9,939,410	11,562,880
Assets Limited as to Use (Notes 2 and 3)	-	6,801,091
Property and Equipment - Net (Note 5)	21,087,833	13,498,215
Other Assets		
Bond issue costs	701,483	542,781
Long-term investments (Note 2)	2,916,407	4,223,595
Other noncurrent assets	301,521	21,636
Total assets	\$ 34,946,654	\$ 36,650,198
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 8)	\$ 418,478	\$ 301,908
Accounts payable	1,395,612	1,284,894
Estimated third-party payor settlements (Note 7)	403,621	1,000,000
Construction contracts payable	856,647	2,070,183
Accrued liabilities and other (Note 6)	2,518,558	2,402,029
Total current liabilities	5,592,916	7,059,014
Long-term Debt (Note 8)	12,244,430	12,606,641
Total liabilities	17,837,346	19,665,655
Net Assets		
Invested in capital assets - Net of related debt	8,424,925	589,666
Restricted by donor for specific purpose	540,605	28,411
Restricted for capital acquisitions	-	4,196,015
Unrestricted	8,143,778	12,170,451
Total net assets	17,109,308	16,984,543
Total liabilities and net assets	\$ 34,946,654	\$ 36,650,198

Sturgis Hospital and Related Entities

Combined Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	September 30, 2006	September 30, 2005
Operating Revenues		
Net patient service revenue	\$ 36,609,444	\$ 38,714,428
Other	402,867	353,001
Total operating revenues	37,012,311	39,067,429
Operating Expenses		
Salaries and wages	14,975,328	15,569,671
Employee benefits and payroll taxes	6,386,978	6,252,662
Operating supplies and expenses	5,545,251	5,617,717
Purchased services	975,228	1,084,989
Insurance	698,004	1,033,203
Utilities	799,088	739,276
Other	1,787,123	1,910,795
Fees	4,892,232	5,180,227
Depreciation and amortization	1,280,198	922,048
Total operating expenses	37,339,430	38,310,588
Operating (Loss) Income	(327,119)	756,841
Other Income (Expense)		
Interest income	310,171	168,578
Gain on sale of property	16,228	320,903
Contributions	435,248	281,128
Other income	26,200	595,280
Interest expense	(335,963)	(111,241)
Total other income	451,884	1,254,648
Increase in Net Assets	124,765	2,011,489
Net Assets - Beginning of year	16,984,543	14,973,054
Net Assets - End of year	\$ 17,109,308	\$ 16,984,543

Sturgis Hospital and Related Entities

Combined Statement of Cash Flows

	Year Ended	
	September 30, 2006	September 30, 2005
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	\$ 34,874,088	\$ 37,985,073
Cash payments to suppliers for services and goods	(36,974,325)	(37,211,433)
Other	402,867	353,001
Net cash (used in) provided by operating activities	(1,697,370)	1,126,641
Cash Flows from Noncapital Financing Activities -		
Noncapital financing contributions and other receipts	-	2,781,128
Cash Flows from Investing Activities		
Investment income	310,171	168,578
Sale (purchase) of investments - Net	8,108,279	(7,971,248)
Net cash provided by (used in) investing activities	8,418,450	(7,802,670)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(8,799,055)	(4,627,033)
Proceeds from sale of capital assets	20,940	330,155
Bond issue cost	(164,728)	(550,152)
Proceeds from issuance of long-term debt	-	11,069,877
Interest paid on long-term debt	(335,963)	(111,241)
Principal payments on notes payable	(323,641)	(307,449)
Other	470,001	595,280
Net cash (used in) provided by capital and related financing activities	(9,132,446)	6,399,437
Net (Decrease) Increase in Cash and Cash Equivalents	(2,411,366)	2,504,536
Cash and Cash Equivalents - Beginning of year	5,066,223	2,561,687
Cash and Cash Equivalents - End of year	\$ 2,654,857	\$ 5,066,223
Balance Sheet Classification of Cash		
Current assets	\$ 2,406,367	\$ 2,996,040
Assets limited as to use	248,490	2,070,183
Total cash	\$ 2,654,857	\$ 5,066,223

Sturgis Hospital and Related Entities

Combined Statement of Cash Flows (Continued)

A reconciliation of operating income (loss) to net cash from operating activities is as follows:

	Year Ended	
	September 30, 2006	September 30, 2005
Cash Flows from Operating Activities		
Operating (loss) income	\$ (327,119)	\$ 756,841
Adjustments to reconcile operating (loss) income to net cash from operating activities:		
Depreciation and amortization	1,280,198	922,048
Provision for bad debts	2,333,396	2,010,886
Changes in assets and liabilities:		
Increase in patient accounts receivable	(3,478,360)	(2,740,655)
(Increase) decrease in other current assets	77,183	(59,350)
Decrease in accounts payable	(1,102,818)	(270,287)
Increase in other accrued expenses	116,529	407,158
Increase (decrease) in third-party settlement payables	(596,379)	100,000
Net cash (used in) provided by operating activities	<u>\$ (1,697,370)</u>	<u>\$ 1,126,641</u>

Significant noncash investing, capital, and financing activities for 2006 and 2005 are as follows:

During the year ended September 30, 2006, the Hospital entered into a capital lease agreement in the amount of \$78,000.

During the year ended September 30, 2005, the Hospital entered into a capital lease agreement in the amount of \$74,877. At September 30, 2005, \$2,070,183 of construction in process was included in the construction contract payable balance.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note I - Nature of Business and Significant Accounting Policies

Sturgis Hospital (the "Hospital") is a short-term, acute care facility providing inpatient, outpatient, and home health care services to the Sturgis, Michigan area. The Hospital is a component unit of the City of Sturgis (a municipal corporation). Rental properties are medical and professional buildings that are also a component unit of the City of Sturgis. The accompanying combined financial statements include accounts of the Hospital, a blended component unit that holds rental properties ("Grobheiser"), and a department of the Hospital that is used to fund projects (the "Foundation"). Intercompany transactions and balances between the Hospital and the rental properties have been eliminated in the combination.

Basis of Presentation - The combined financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the business-type activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. The Hospital also applies the Financial Accounting Standards Board statements and interpretations to the extent that they do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less.

Investments - Investments are stated at fair value.

Property and Equipment - Property and equipment purchases are recorded at cost. Leased equipment under capital leases is capitalized at the net present value of future minimum lease payments or the fair market value of the equipment, whichever is less. Depreciation and amortization are charged to operations using the straight-line method over the estimated useful lives of the assets. Maintenance and repairs are charged to expense as incurred.

Compensated Absences - Paid time off is charged to operations when earned. Unused and earned benefits are recorded as a current liability in the combined financial statements.

Operating Revenue and Expenses - The combined statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with provided health care services - the Hospital's principal activity. Nonexchange revenue, including all donations and interest, are reported as nonoperating revenue. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note I - Nature of Business and Significant Accounting Policies (Continued)

Restricted Resources - When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use unrestricted resources before restricted resources.

Net Assets - Net assets of the Hospital are classified in four components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Net assets restricted by donor and net assets restricted for capital acquisitions must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net Patient Service Revenue - The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance of such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusions from the Medicare and Medicaid programs.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care was less than 1 percent of total gross charges for the years ended September 30, 2006 and 2005.

Assets Limited as to Use - Assets limited as to use include unspent bond funds to be used for capital additions, funds required to be set aside under the terms of the bond agreement and assets temporarily restricted by donors. Amounts required to meet current liabilities of the Hospital have been reclassified in the combined balance sheet.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

2006

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At September 30, 2006, the Hospital had \$2,572,716 of bank deposits (certificates of deposit, checking and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At September 30, 2006, the following investment securities were held by a counterparty, not considered a financial institution:

Investment	Carrying Value	How Held
JP Morgan	\$ 221,073	Counterparty
Linsco/Private ledger	671,863	Counterparty
Security benefit	136,969	Counterparty

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At September 30, 2006, the average maturities of investments are as follows:

Investment	Fair Value	Maturities
Commercial paper	\$ 542,129	11/14/2006
Municipal bonds	50,440	05/01/2012
Municipal bonds	52,460	08/01/2011
Municipal bonds	25,250	10/01/2009

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's investment policy also states that any investments in obligations of the State of Michigan or any of its political subdivisions must be rated as investment grade by at least one rating service. As of September 30, 2006, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Commercial paper	\$ 542,129	A	Standards & Poors'
Municipal bonds	50,440	AAA	Moody's
Municipal bonds	52,460	AA2	Moody's
Municipal bonds	25,250	AAA	Moody's

Concentration of Credit Risk - The Hospital's investment policy states that not more than 50 percent of the cash and investments the Hospital holds can be invested in commercial paper at any one time. The policy goes on to state that not more than 25 percent of the cash and investments may be invested in one type of investment.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

2005

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At September 30, 2005, the Hospital had \$9,388,689 of bank deposits (certificates of deposit and checking and savings accounts) that were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At September 30, 2005, the following investment securities were held by a counterparty, not considered a financial institution:

Investment	Carrying Value	How Held
JP Morgan	\$ 6,918,326	Counterparty
Linsco/Private ledger	1,055,809	Counterparty
Security benefit	2,107,889	Counterparty

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity. At September 30, 2005, the average maturities of investments are as follows:

Investment	Fair Value	Maturities
Commercial paper	\$ 404,596	11/22/05
Commercial paper	491,995	2/17/06
Municipal bonds	25,218	2/1/09
Municipal bonds	51,185	5/1/12
Municipal bonds	53,395	8/1/11
Municipal bonds	25,250	10/1/09

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

Credit Risk - State law limits investments in commercial paper to the top two ratings issued by nationally recognized statistical rating organizations. The Hospital's investment policy also states that any investments in obligations of the State of Michigan or any of its political subdivisions must be rated as investment grade by at least one rating service. As of September 30, 2005, the credit quality ratings of debt securities (other than the U.S. government) are as follows:

Investment	Fair Value	Rating	Rating Organization
Corporate bonds	\$ 404,596	A	Standard & Poor's
Corporate bonds	491,995	A	Standard & Poor's
Municipal bonds	25,218	BAA	Moody's
Municipal bonds	51,185	AAA	Moody's
Municipal bonds	53,395	AA	Standard & Poor's
Municipal bonds	25,250	AAA	Standard & Poor's

Concentration of Credit Risk - The Hospital has stated that not more than 50 percent of the cash and investments the Hospital holds can be invested in commercial paper at any one time. The policy goes on to state that not more than 25 percent of the cash and investments may be invested in one type of investment. In addition, no one financial institution may hold 25 percent of the Hospital's cash and investments.

As a result of the bond issuances the Hospital made during the year, it has 43 percent of its cash and investments held at JP Morgan. The investments at JP Morgan are exclusively government-backed securities. Along with one other institution, the amount of government-backed securities held by the Hospital is 27 percent. The funds held by JP Morgan were substantially all spent during the fiscal year ended 2006, as they related to the current construction project. The Hospital also has 31 percent of its cash and investments held at one financial institution.

Note 3 - Assets Limited as to Use

Assets limited as to use consist of the following:

	2006	2005
Donor restricted for specific purposes	\$ 8,436	\$ 28,411
Bond funds for capital purchases	-	6,266,198
Bond funds for principal and interest	240,054	640,864
Board designated for capital purchases	-	1,935,801
Total	248,490	8,871,274
Less current portion	(248,490)	(2,070,183)
Noncurrent portion	\$ -	\$ 6,801,091

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 4 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below as follows:

	2006	2005
Patient accounts receivable	\$ 11,296,022	\$ 9,594,943
Less:		
Allowance for uncollectible accounts	(1,487,000)	(1,203,000)
Allowance for contractual adjustments	(3,761,000)	(3,209,000)
Net patient accounts receivable	<u>\$ 6,048,022</u>	<u>\$ 5,182,943</u>

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	Percent	
	2006	2005
Medicare	34	26
Blue Cross Blue Shield of Michigan	10	12
Medicaid	8	10
Commercial insurance and HMOs	18	25
Self-pay	30	27
Total	<u>100</u>	<u>100</u>

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 5 - Capital Assets

Costs of capital assets and related depreciable lives for September 30, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land and land improvements	\$ 492,850	\$ -	\$ -	\$ -	\$ 492,850	8-15
Building and improvements	5,824,467	7,117,742	5,661,826	(6,055)	18,597,980	15-40
Rental buildings and improvements	5,452,212	-	-	-	5,452,212	5-40
Furniture, fixtures, and equipment	14,942,418	1,759,313	316,399	(131,947)	16,886,183	5-20
Construction in progress	5,978,225	-	(5,978,225)	-	-	-
Total	32,690,172	8,877,055	-	(138,002)	41,429,225	
Less accumulated depreciation:						
Land and land improvements	225,861	9,721	-	-	235,582	
Building and improvements	4,008,389	416,333	-	(3,472)	4,421,250	
Rental buildings and improvements	2,568,168	130,844	-	-	2,699,012	
Furniture, fixtures, and equipment	12,389,539	717,275	-	(121,266)	12,985,548	
Total	19,191,957	1,274,173	-	(124,738)	20,341,392	
Net carrying amount	\$ 13,498,215	\$ 7,602,882	\$ -	\$ (13,264)	\$ 21,087,833	

Costs of capital assets and related depreciable lives for September 30, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 492,850	\$ -	\$ -	\$ -	\$ 492,850	8-15
Buildings and improvements	5,755,751	68,716	-	-	5,824,467	15-40
Rental buildings and improvements	5,445,101	7,111	-	-	5,452,212	5-40
Furniture, fixtures, and equipment	13,939,495	1,061,923	-	(59,000)	14,942,418	5-20
Construction in progress	418,762	5,667,565	-	(108,102)	5,978,225	-
Total	26,051,959	6,805,315	-	(167,102)	32,690,172	
Less accumulated depreciation:						
Land and land improvements	216,140	9,721	-	-	225,861	
Buildings and improvements	3,778,335	230,054	-	-	4,008,389	
Rental buildings and improvements	2,436,652	131,516	-	-	2,568,168	
Furniture, fixtures, and equipment	11,895,902	543,385	-	(49,748)	12,389,539	
Total	18,327,029	914,676	-	(49,748)	19,191,957	
Net carrying amount	\$ 7,724,930	\$ 5,890,639	\$ -	\$ (117,354)	\$ 13,498,215	

Construction Commitments - At September 30, 2006, the Hospital had remaining commitments related to the construction project approximating \$1,150,000. This project is expected to be completed during the fiscal year ending September 30, 2007.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 6 - Accrued Liabilities

The details of accrued liabilities at September 30, 2006 and 2005 are as follows:

	2006	2005
Payroll and related items	\$ 789,944	\$ 719,176
Compensated absences	1,021,541	1,001,604
Professional liability claims (Note 8)	43,509	37,174
Self-insurance health benefit liability (Note 8)	400,000	400,000
Interest	244,361	229,345
Other	19,203	14,730
Total accrued liabilities	<u>\$ 2,518,558</u>	<u>\$ 2,402,029</u>

Note 7 - Cost Report Settlements

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Approximately 60 percent of the Hospital's net patient service revenue is received from the Medicare, Medicaid, and Blue Cross Blue Shield of Michigan programs. A summary of the basis of reimbursement with these third-party payors is as follows:

- **Medicare** - Inpatient, acute-care, and rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Inpatient psychiatric and substance abuse services are reimbursed at cost subject to a per-case limit. Outpatient and homecare services related to Medicare beneficiaries are reimbursed based on a prospectively determined amount per episode of care.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. Outpatient and physician services are reimbursed on an established fee-for-service methodology.
- **Blue Cross Blue Shield of Michigan** - Inpatient, acute-care services are reimbursed at prospectively determined rates per discharge. Outpatient services are reimbursed on a fee-for-service and percentage-of-charge basis.

Cost report settlements result from the adjustment for interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material impact on the accompanying combined financial statements.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 8 - Long-term Debt

Long-term liability activity for the year ended September 30, 2006 was as follows:

	2005	Current Year Additions	Current Year Reductions	2006	Amounts Due Within One Year
Bonds - 2004	\$ 10,000,000	\$ -	\$ -	\$ 10,000,000	\$ 125,000
Bonds - 2005	995,000	-	-	995,000	15,000
Memorial Health Systems note	429,000	-	(52,000)	377,000	52,000
Century Bank & Trust building loan	208,370	-	(11,660)	196,710	12,274
Century Bank & Trust equipment loan	13,727	-	(1,534)	12,193	1,604
Century Bank & Trust R&F Loan	307,792	-	(16,901)	290,891	17,625
City of Sturgis - Electric Fund	485,448	-	(26,969)	458,479	26,969
City of Sturgis - Electric Fund	223,692	-	(76,658)	147,034	81,386
City of Sturgis - Bonds	87,500	-	(32,083)	55,417	35,000
GE Financial Health Care loan (capital lease)	23,311	-	(9,130)	14,181	9,851
GE Fetal Monitors loan (capital lease)	1,311	-	(1,311)	-	-
Sturgis Bank & Trust loan (capital lease)	58,521	-	(58,521)	-	-
GE Bone Densitometer (capital lease)	74,877	-	(15,208)	59,669	15,769
Highland iCad SL 300 System (capital lease)	-	78,000	(21,666)	56,334	26,000
Total long-term debt	<u>\$ 12,908,549</u>	<u>\$ 78,000</u>	<u>\$ (323,641)</u>	<u>\$ 12,662,908</u>	<u>\$ 418,478</u>

Long-term liability activity for the year ended September 30, 2005 was as follows:

	2004	Current Year Additions	Current Year Reductions	2005	Amounts Due Within One Year
Bonds - 2004	\$ -	\$ 10,000,000	\$ -	\$ 10,000,000	\$ -
Bonds - 2005	-	995,000	-	995,000	-
Memorial Health Systems note	481,000	-	(52,000)	429,000	52,000
Century Bank & Trust building loan	219,449	-	(11,079)	208,370	11,660
Century Bank & Trust equipment loan	15,193	-	(1,466)	13,727	1,531
Century Bank & Trust R&F Loan	323,999	-	(16,207)	307,792	16,901
City of Sturgis - Electric Fund	512,417	-	(26,969)	485,448	26,969
City of Sturgis - Electric Fund	295,896	-	(72,204)	223,692	76,658
City of Sturgis - Bonds	117,500	-	(30,000)	87,500	32,083
GE Financial Health Care loan (capital lease)	31,774	-	(8,463)	23,311	9,130
GE Fetal Monitors loan (capital lease)	27,125	-	(25,814)	1,311	1,311
Sturgis Bank & Trust loan (capital lease)	121,768	-	(63,247)	58,521	58,521
GE Bone Densitometer (capital lease)	-	74,877	-	74,877	15,144
Total long-term debt	<u>\$ 2,146,121</u>	<u>\$ 11,069,877</u>	<u>\$ (307,449)</u>	<u>\$ 12,908,549</u>	<u>\$ 301,908</u>

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 8 - Long-term Debt (Continued)

The details of long-term debt are summarized as follows:

- Sturgis Building Authority Michigan Building Authority Bonds, Series 2004 Bonds, payable annually beginning October 1, 2006 and ending October 1, 2034, ranging from \$125,000 to \$725,000, plus interest paid semiannually with rates ranging from 3.75 percent to 4.75 percent, are collateralized by hospital assets.
- Sturgis Building Authority Michigan Building Authority Bonds, Series 2004 Bonds, payable annually beginning October 1, 2006 and ending October 1, 2034, ranging from \$15,000 to \$60,000, plus interest paid semiannually with rates ranging from 4.25 percent to 4.8 percent, are collateralized by hospital assets.
- The Memorial Health System note bears interest at prime as of January 1 of the Hospital's fiscal year, is payable in monthly installments of \$4,333 plus interest, is collateralized by certain buildings, and is due in January 2009.
- The Century Bank & Trust building loan bears interest at 5.15 percent, is payable in monthly installments of \$1,843, including interest, is collateralized by certain buildings, and is due in full in August 2018.
- The Century Bank & Trust equipment loan bears interest at 4.5 percent, is payable in monthly installments of \$177, including interest, is collateralized by certain equipment, and is due in full in June 2013.
- The Century Bank & Trust R&F loan bears interest at 4.2 percent, is payable in monthly installments of \$2,459, including interest, is collateralized by certain equipment, and is due in full in June 2019.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$2,247, plus interest at 6 percent, due in full in September 2023, and is collateralized by improvements to rental office building.
- The City of Sturgis - Electrical Fund note is payable in monthly installments of \$7,333, including interest at 6 percent, is due in full in June 2008, and is collateralized by improvements to the rental office building.
- The City of Sturgis - Bonds, a loan from the City of Sturgis for repayment of bonds, are payable in monthly installments of \$6,402, including interest at 4.96 percent, are due in full in April 2008, and are collateralized by hospital revenue.
- The GE Financial Health Care loan is a capital lease obligation with monthly payments of \$883, including imputed interest of 7.62 percent, for the year ended September 30, 2006, and is collateralized by equipment.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 8 - Long-term Debt (Continued)

- The GE Financial Services loan is a capital lease obligation with monthly payments of \$1,492, including imputed interest of 4 percent, for the year ended September 30, 2006, and is collateralized by equipment.
- The Highland Capital Corporation loan is a capital lease obligation with monthly payments of \$2,167 for the year ended September 30, 2006, and is collateralized by equipment.

The following is a schedule by years of bond principal and interest as of September 30, 2006:

Years Ending September 30	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2007	\$ 366,858	\$ 574,656	\$ 51,620	\$ 2,873
2008	348,014	555,219	46,748	1,567
2009	273,493	539,329	21,433	802
2010	285,112	525,962	10,383	143
2011	296,645	499,172	-	-
2012-2016	1,546,963	2,358,417	-	-
2017-2021	1,731,700	2,012,813	-	-
2022-2026	2,068,939	1,612,465	-	-
2027-2031	2,735,000	1,084,474	-	-
2032-2034	2,880,000	347,209	-	-
Total	<u>\$ 12,532,724</u>	<u>\$ 10,109,716</u>	<u>\$ 130,184</u>	<u>\$ 5,385</u>

Note 9 - Risk Management

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries (workers' compensation), as well as medical benefits provided to employees. The Hospital has purchased commercial insurance for malpractice and general liability claims and participates with the City of Sturgis for claims relating to workers' compensation; the Hospital is self-insured for medical benefits claims.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 9 - Risk Management (Continued)

Self-insured Health Benefits - Changes in the estimated liability for the past two years were as follows:

	2006	2005
Estimated liability - Beginning of year	\$ 400,000	\$ 400,000
Estimated claims incurred, including changes in estimates	3,404,857	3,386,886
Claim payments	<u>(3,404,857)</u>	<u>(3,386,886)</u>
Estimated liability - End of year	<u>\$ 400,000</u>	<u>\$ 400,000</u>

Malpractice - The Hospital is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital must pay a deductible toward the cost of litigating or settling any asserted claims. In addition, the Hospital bears the risk of the ultimate costs of any individual claim exceeding the policy limits for claims asserted in the policy year.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

The Hospital has been named a defendant in several malpractice suits. At this time, it is premature to evaluate the likely outcomes, amounts of settlements, if any, or whether they could exceed the insurance coverage. Management intends to vigorously defend these suits and does not expect any unfavorable impacts. Accordingly, an accrual has been made in Note 6 of these combined financial statements for the deductible potentially payable by the Hospital on the malpractice suits for the years ended September 30, 2006 and 2005.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 10 - Defined Benefit Pension Plan

Plan Description - The Hospital participates in the City of Sturgis Employees' Retirement System (the "System"), which is a multi-employer defined benefit pension plan administered by the City of Sturgis. This plan covers all employees of the City of Sturgis, including the Hospital, who normally work 1,000 hours or more a year. The System provides retirement, disability, and death benefits to plan members and their beneficiaries. At December 31, 2005, the date of the most recent actuarial valuation, Hospital membership consisted of 71 retirees and beneficiaries currently receiving benefits and 106 current active retirees. The plan does not issue a separate financial report.

Contributions - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings. There are no employee contributions.

Annual Pension Costs - For the year ended September 30, 2006, the City's annual pension cost for the plan was equal to the City's required and actual contribution. The Hospital's annual pension costs were \$1,301,067, \$1,272,000, and \$928,100 in 2006, 2005, and 2004, respectively. The annual required contribution was determined as part of an actuarial valuation at December 31, 2005, using the entry actual age cost method. Significant actuarial assumptions used include (a) a 7 percent investment rate of return, (b) projected salary increases of 4.5 percent to 17.5 percent per year, and (c) no cost of living adjustments. Both (a) and (b) include an inflation component of 4.5 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a five-year period. The assets as of the valuation date were less than the accrued liabilities for all divisions. Due to the underfunding of the plan, it is anticipated that the contribution requirement will be increased in future years.

Sturgis Hospital and Related Entities

Notes to Combined Financial Statements September 30, 2006 and 2005

Note 10 - Defined Benefit Pension Plan (Continued)

The following table sets forth the funded status and amounts for the defined benefit plan:

	2005	2004	2003
Actual pension cost (APC)	\$ 1,739,597	\$ 1,437,413	\$ 1,101,164
Percentage of APC contributed	118 %	94 %	93 %
Actuarial value of assets	\$ 47,369,804	\$ 45,968,634	\$ 45,375,025
Actuarial accrued liability (entry age)	\$ 50,314,340	\$ 47,243,463	\$ 45,635,562
Underfunded actuarial accrued liability	\$ (2,944,536)	\$ (1,274,829)	\$ (260,537)
Funded ratio	94 %	97 %	99 %
Covered payroll	\$ 18,671,016	\$ 19,515,461	\$ 19,158,737
Underfunded actuarial accrued liability as a percentage of covered payroll	(16)%	(6)%	(1)%

Note 11 - Postemployment Health Care Benefits

In addition to providing pension benefits, the Hospital provides certain health care benefits for retirees. Substantially all the Hospital's employees may become eligible for those benefits if they reach normal retirement age while working for the Hospital. Currently, 71 retirees meet those eligibility requirements. The Hospital is self-insured for retirees' medical benefit claims. The Hospital's net cost for providing retirees' health care benefits was \$782,393 and \$431,564 (after retirees' contributions of \$87,753 and \$83,837) for the years ended September 30, 2006 and 2005, respectively.

Note 12 - Upcoming Reporting Changes

The Governmental Accounting Standards Board has recently released Statement No. 45, *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*. The new pronouncement provides guidelines for local units of government in recognizing the cost of retiree health care, as well as any "other" postemployment benefits (other than pensions). The new rules will cause the government-wide combined financial statements to recognize the cost of providing retiree health care coverage over the working life of the employee, rather than at the time the health care premiums are paid. The new pronouncement is effective for the year ending September 30, 2008 for Sturgis Hospital.

Additional Information



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To the Board of Directors
Sturgis Hospital and Related Entities

We have audited the combined financial statements of Sturgis Hospital and Related Entities as of September 30, 2006 and 2005. Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole. The accompanying combining balance sheet and statement of operations are presented for the purpose of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies and are not required parts of the basic combined financial statements. The combining information has been subjected to the procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

Plante & Moran, PLLC

November 2, 2006

Sturgis Hospital and Related Entities

Combining Balance Sheet September 30, 2006

	Sturgis Hospital	Grobheiser	Sturgis Hospital Foundation	Eliminating Entries	Total
Assets					
Current Assets					
Cash and cash equivalents	\$ 2,406,367	\$ -	\$ 146,436	\$ (146,436)	\$ 2,406,367
Accounts receivable	5,926,052	16,122	105,848	-	6,048,022
Notes and advances to affiliates	1,196,465	-	-	(1,196,465)	-
Assets limited as to use	248,490	-	-	-	248,490
Other current assets	1,082,986	7,109	-	146,436	1,236,531
Total current assets	10,860,360	23,231	252,284	(1,196,465)	9,939,410
Property and Equipment	18,334,634	2,753,199	-	-	21,087,833
Other Assets					
Bond issue costs	701,483	-	-	-	701,483
Long-term investments	2,916,407	-	-	-	2,916,407
Other noncurrent assets	21,636	-	279,885	-	301,521
Total assets	<u>\$ 32,834,520</u>	<u>\$ 2,776,430</u>	<u>\$ 532,169</u>	<u>\$ (1,196,465)</u>	<u>\$ 34,946,654</u>
Liabilities and Net Assets					
Current Liabilities					
Current portion of long-term debt	\$ 275,123	\$ 143,355	\$ -	\$ -	\$ 418,478
Notes payable	-	1,196,465	-	(1,196,465)	-
Accounts payable	1,394,412	1,200	-	-	1,395,612
Estimated third-party payor settlements	403,621	-	-	-	403,621
Construction contracts payable	856,647	-	-	-	856,647
Accrued liabilities and other	2,518,558	-	-	-	2,518,558
Total current liabilities	5,448,361	1,341,020	-	(1,196,465)	5,592,916
Long-term Debt	11,726,855	517,575	-	-	12,244,430
Total liabilities	17,175,216	1,858,595	-	(1,196,465)	17,837,346
Net Assets					
Invested in capital assets - Net of related debt	6,332,656	2,092,269	-	-	8,424,925
Restricted by donor for specific purpose	8,436	-	532,169	-	540,605
Unrestricted	9,318,212	(1,174,434)	-	-	8,143,778
Total net assets	15,659,304	917,835	532,169	-	17,109,308
Total liabilities and net assets	<u>\$ 32,834,520</u>	<u>\$ 2,776,430</u>	<u>\$ 532,169</u>	<u>\$ (1,196,465)</u>	<u>\$ 34,946,654</u>

Sturgis Hospital and Related Entities

Combining Statement of Operations Year Ended September 30, 2006

	Sturgis Hospital	Grobheiser	Sturgis Foundation	Eliminating Entries	Totals
Operating Revenues					
Net patient service revenue	\$ 36,609,444	\$ -	\$ -	\$ -	\$ 36,609,444
Other	219,147	298,023	-	(114,303)	402,867
Total operating revenues	36,828,591	298,023	-	(114,303)	37,012,311
Operating Expenses					
Salaries and wages	14,998,294	-	-	(22,966)	14,975,328
Employee benefits and payroll taxes	6,386,978	-	-	-	6,386,978
Operating supplies and expenses	5,540,005	5,246	-	-	5,545,251
Purchased services	969,135	23,556	-	(17,463)	975,228
Insurance	693,921	4,083	-	-	698,004
Utilities	702,969	96,119	-	-	799,088
Other	1,808,744	-	-	(21,621)	1,787,123
Fees	4,938,485	6,000	-	(52,253)	4,892,232
Depreciation and amortization	1,149,354	130,844	-	-	1,280,198
Total operating expenses	37,187,885	265,848	-	(114,303)	37,339,430
Operating Income (Loss)	(359,294)	32,175	-	-	(327,119)
Other Income (Expense)					
Interest income	310,171	-	-	-	310,171
Gain on sale of property	16,228	-	-	-	16,228
Contributions	342,975	-	382,893	(275,000)	450,868
Disbursements for specific purpose	-	-	(290,620)	275,000	(15,620)
Other income	26,200	-	-	-	26,200
Interest expense	(291,079)	(44,884)	-	-	(335,963)
Total other income (expense)	404,495	(44,884)	92,273	-	451,884
Increase (Decrease) in Net Assets	\$ 45,201	\$ (12,709)	\$ 92,273	\$ -	\$ 124,765